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December 19, 2002

VIA ELECTRONIC FILING

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S. W. – Room TWB-204
Washington, D. C. 20554

Re: *Ex parte*, WC Docket No. 01-337, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services

Dear Ms. Dortch:

On Monday, December 18, 2002, Leonard Cali and the undersigned of AT&T met by telephone with Commissioner Michael Copps. During our conversation we briefly discussed the topics contained in the attached written ex parte letter.

One electronic copy of this Notice is being submitted to the Secretary of the FCC in accordance with Section 1.1206 of the Commission's rules.

Sincerely,

F. S. Simone

ATTACHMENT

cc: Hon. M. Copps
J. Goldstein

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December 18, 2002

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337

Dear Ms. Dortch:

On October 31, 2001, SBC Communications filed a petition seeking a blanket and immediate declaration of non-dominance with respect to *all* of its "broadband" services, wherever and to whomever provided or, alternatively, that the Commission forbear from applying dominant carrier regulations to all such services. That request should have been rejected out of hand as entirely unsupported. But unless the Commission acts expeditiously and issues an order denying the petition, the forbearance request will be deemed granted by operation of law. The Commission must not allow that to happen. Reclassifying entire categories of SBC's services as "nondominant" without conducting any serious market analyses would not only be a clear departure from established precedent (and the record evidence), but could also impair the Commission's ability to reach the right results in this proceeding and a host of others, including the *Wireline Broadband* proceeding and the *Triennal Review* proceeding.

SBC did not even make a *prima facie* showing that it lacks relevant market power – the *sine qua non* of any reasoned nondominance determination – with respect to any of the services it seeks to have reclassified. Indeed, although it now concedes that the relevant markets are local (because a residential or business consumer in a particular locality can only turn to the broadband providers that serve that locality) and that competitive activity varies widely from one locality to the next, SBC did not provide competition data for a *single* local market for *any* service. And it quickly became clear that for many of the services at issue and in many localities, SBC either faces *no* meaningful competition or controls bottleneck input facilities, *i.e.*, marketplace conditions that the Commission and the courts have consistently held plainly *do* create market power and demand dominant carrier classification.

That is true of the broadband services SBC provides to small businesses – SBC's DSL services may compete with its own T1, ISDN, and other high margin dedicated business services, but rarely face any competition from cable facilities that do not even *serve* business districts. It is true of the broadband transmission services that SBC provides to ISPs – although a few ISPs have obtained cable carriage deals in some localities, the vast majority of ISPs in the vast majority of SBC's service areas have no alternative to SBC's facilities. It is true of the ATM and frame relay services that SBC provides to large businesses – SBC controls the special access facilities that are essential inputs to those services, and SBC has already abused its control over those bottleneck facilities to gain more than a *90 percent* market share of the local frame and ATM business to which it was limited before gaining section 271 authority. In many cases, it is true even of the retail residential broadband Internet services where cable is active. As the California PUC has stressed, for example, "forty-five percent of Californians that live in cities with broadband service have DSL service as their *only* broadband option."[1] Of course, even where cable and DSL do compete head-to-head that establishes only duopoly conditions that the Commission held in the *DirecTV-Echostar* proceeding cannot be relied upon to constrain market power. In any event, the retail residential broadband Internet services upon which SBC has focused are, as the Commission has already tentatively concluded, information services, and thus *are not even subject to* the Title II dominant carrier regulations SBC seeks to evade.

On this record, it is difficult to comprehend why SBC's petition has not already been denied. Whatever one's view of the broader legal and policy questions pending in this and related proceedings, it is quite plain that SBC did not with respect to *any* broadband service – much less *all* of its broadband services – come anywhere close to satisfying its burden to justify, with record support, its vastly overbroad request for reclassification or, alternatively, forbearance. That does not mean that regulation of SBC's (or other Bells') broadband services must remain forever unchanged. The broader issues remain pending and will presumably be resolved in the near future, and SBC and others remain free to seek – and justify – more targeted relief through forbearance or other avenues. It would be the height of arbitrariness, however, to ignore both undisputed marketplace conditions and the obvious holes in SBC's support for its petition and to grant the petition in any respect.

If there is nonetheless concern that dominant carrier regulation of SBC's retail DSL services could impair SBC's ability to compete with cable modem services – and SBC's success in the marketplace confirms that no such concern is warranted – the right answer is *not* to grant nondominance or forbearance relief that has not been and could not be justified. Rather, the Commission should simply rule, as it has already tentatively concluded, that those particular

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[1] *See* Comments of California, CC Docket No. 02-33, at 28 (filed May 3, 2002); *see also Broadband 2001 Report*, Chart 25 (estimating that only 33% of consumers had a choice of DSL and cable modem services and that 38% had DSL as their only option).

SBC services are not subject to Title II dominant carrier regulations, because they are information services, not Title II telecommunications services.

If the concern is that the Commission should not prejudge that classification issue, but that dominant carrier tariffing and cost support regulation of retail residential DSL services nonetheless imposes intolerable costs on the Bells – and neither SBC nor any of the other Bells has ever been able to document that, or, indeed, even to articulate how that could possibly be so – SBC can certainly expect no more than a ruling that the Commission will forbear from applying tariffing and cost support regulations to those services, to the extent they are provided through a structurally separate affiliate, and in localities where there is, in fact, ubiquitous cable competition. Any such ruling should be based not upon the fiction that SBC (or its affiliate) is nondominant or lacks market power, but upon a determination that the indisputable benefits of tariffing and cost support are somehow outweighed by administrative and other costs in this particular context. Even that would be an unlawful and anticompetitive disposition of SBC's petition. But it would be vastly superior to an unjustified finding of nondominance, which would necessarily be accompanied by an explicit or implicit finding of no market power that the Bells would thereafter wield as a sword at the Commission and the court of appeals in furtherance of their broader anticompetitive agenda in the wireline broadband and related proceedings.

It bears repeating that even this more targeted forbearance with respect to DSL services in areas where SBC actually faces serious cable competition could not be reconciled with the law or sound economics. SBC does not, and could not, dispute that most ISPs in most local markets have *no* choice but the Bells for last mile broadband transport. Where there are no alternatives, market power generally exists. And as the record in this proceeding overwhelmingly demonstrates, duopoly *retail* competition with cable (where it exists) is patently inadequate to overcome the Bells' anticompetitive incentives to overprice and underpromote DSL services to protect their high profit dial-up, second line, T1 and other legacy services – and to deny reasonable access requests from ISPs and carriers that might threaten that anticompetitive strategy. That is why independent ISPs in this and related proceeding have vigorously opposed the elimination of the existing tariffing and cost support regulations that remain important tools in the detection and deterrence of market power abuse.

The Bells argue that the existence of effective *retail* competition removes their incentives to abuse that power. Because retail customers value ISP choice, the argument goes, the Bells (like their cable competitors) will have every incentive to grant third party access to their broadband facilities upon reasonable terms and conditions simply to please and attract retail consumers to their networks. But, even assuming that duopoly alone could exert such market forces – and the Commission has recently held that it cannot[2] – that argument ignores the Bells'

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[2] *See EchoStar-DirecTV Merger Order* ¶ 103 ("[E]xisting antitrust doctrine suggests that a merger to duopoly or monopoly faces a strong presumption of illegality."); *id.*, Statement of Chairmen Powell ("At best, this merger would create a duopoly in areas served by cable; at

unique anticompetitive incentives and the overwhelming record evidence in these proceedings that demonstrates that existing and foreseeable levels of retail competition between cable and DSL will *not* persuade the Bells to accommodate all reasonable access requests from their competitors.

As the Bells have acknowledged, broadband services "*are increasingly likely to cannibalize the traditional services offered by ILECs.*"[3] For example, one "cost[] of DSL is the fact that "about 30% of new DSL subscribers give up a second phone line" which earn higher margins than DSL.[4] Similarly, DSL is a substitute for premium-priced T1, fractional T1, and ISDN services that the Bells provide to small businesses.

Because of this "cannibilization" effect, the Bells' profit-maximizing price for DSL will not be the competitive price, but a much higher price. Bell DSL pricing is thus a balancing act – high enough to slow the migration from legacy Bell services to DSL, but not too high to cause mass customer migration to cable. And the Bells' ability to retain and gain customers notwithstanding 25 percent DSL price hikes that were not matched by cable confirms that the Bells do unquestionably have the power to sustain enormous price increases that confirm market power.[5] That is unsurprising given that cable modem services are not perfect substitutes for the Bells' DSL services (*e.g.*, most cable providers cannot match the Bells' voice/DSL bundle) and that duopoly can rarely be counted on to produce competitive market incentives.

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worst it would create a merger to monopoly in unserved areas. Either result would decrease incentives to reduce prices, increase the risk of collusion, and inevitably result in less innovation and fewer benefits to consumers. That is the antithesis of what the public interest demands.").

[3] BellSouth Triennial Review Reply, NERA Reply Report ¶ 167 (emphasis added). *See also* Goldman Sachs, *Telecom Services*, at 15 (June 11, 2002) ("[A] negative side effect of adding a DSL subscriber is the potential loss of a second line that the customer had previously subscribed to. *SBC estimates that as much as one-half of customers with second lines that sign up for DSL service disconnect their second lines, Verizon estimates that this figure is closer to three-quarters.* . . . Second lines generate only $25 per month in revenue and come at a very low incremental cost to the provider, implying very high returns. Alternatively, DSL requires significant upfront acquisition costs as well as infrastructure costs. . . . *A DSL subscriber often comes at the expense of a disconnected second line, which means $25 in high-margin revenues are lost.*") (emphasis added).

[4] BellSouth Triennial Review Reply Comments, Harris Reply Dec., Att. 2 (DSL Business Case) at 3.

[5] After the collapse of the data LEC industry, the Bells responded by raising their prices by 25% and ending the prior practice in which their retail services that used the lowest-speed Internet access service had been priced at the same level as cable modem service. *See* AT&T ILEC Broadband Dominance Comments, Willig Dec. ¶¶ 21-23, 102-13.

For these reasons, when the Bells raise prices for DSL, they both increase the margins on that service and diminish the incentives of current second line/T1 subscribers to switch to DSL, thereby increasing revenue from those legacy services (and overall Bell profits).[6] These same incentives mean that the Bells have no interest in offering competitively-priced access to their last-mile broadband transport, either for competitive carriers or ISPs. The Bells know that if they give reasonable wholesale access, competitors using that access will both undercut the Bells' bloated DSL charges and "overpromote" DSL in ways that could only accelerate the Bells' loss of second line and T1/ISDN subscribers. For these reasons, relieving SBC of dominant carrier regulation of its DSL services plainly could not serve the public interest.

Finally, whatever the ultimate resolution of SBC's request with respect to DSL services provided to residential and ISP customers, there is no possible basis for the relief SBC seeks with respect to broadband services it provides to small and large businesses. Cable is not generally available in business districts at all; virtually all small business customers of cable are in suburban areas that contain or are immediately adjacent to residences. Thus, "[m]ore than 80 percent of midsize and small businesses are sufficiently close to a telephone-switching office to subscribe to DSL, whereas cable, having started out as an entertainment medium, reaches fewer than 20 percent of such businesses in the United States."[7] Perhaps the best evidence that DSL generally does not face facilities-based competition for small businesses is Bell pricing – the same or similar broadband services provided to businesses are much more expensive than the services provided to residential customers.[8]

The situation is no better for large business services such as ATM and frame relay that are provided over high capacity loops and transport facilities. Self-deployment of these transmission facilities is generally not economic, and only a tiny fraction of buildings are

[6] It presumably for this reason that the Bells have begun to state publicly that DSL is priced "too low." Vikas Bajaj, *Phone, Broadband Prices Too Low, Verizon Exec Says*, Dallas Morning News (June 5, 2002) ("Digital subscriber lines, which cost about $50 a month today, should be 40 percent to 50 percent more expensive, [Verizon's Vice Chairman and President] told reporters at a news conference.").

[7] *See* Inc.com (summarizing July 2001 McKinsey study).

[8] For example, Qwest offers 256 kbps residential DSL at $39.95, but charges $139 per month for 256 kbps business DSL. *Compare* http://qwest.com/residential/products/dsl/index.html *with* http://www.qdslonline.com/prod/offer.html). Similarly, "T1 and fractional T1 continue to prosper. ILEC salesforces are motivated to sell T1 first and DSL second. . . . The ILECs have done very little to push DSL to small businesses." Yankee Report (August 2002). Overall, "[e]ven though business subscribers only represent 23% of the total DSL subscribers, they comprise 56% of all DSL revenues in the US . . . . On average a business customer's DSL service will amount to a $200.00 charge monthly." 2002 In-Stat Report.

actually served by alternative facilities-based suppliers.[9] SBC stresses that long distance carriers currently account for more than two-thirds of the *retail* provision of ATM and frame relay. But SBC inappropriately lumps together *both* local *and* interLATA data services, the latter of which most Bells have only recently begun to provide (as they obtain section 271 authority). In the local markets where the Bells have been able to compete, in contrast, they have already parlayed their control over bottleneck facilities into control of over 90 percent of the retail ATM and frame services provided to large businesses – clear confirmation of enduring market power.[10] Indeed, the very source that the SBC cites in its petition concludes: the "[m]essage[] in the [d]ata [is that t]he RBOCs will continue to dominate" the markets for these services because they control the bottleneck facilities necessary to provide these services.[11]

In sum, the Commission should deny the SBC petition in all respects, and will face formidable challenges on appeal if it does not do so. But if the Commission nonetheless determines that SBC should be granted some of the relief it seeks, the Commission should, as outlined above, take great care in how it accomplishes that result to avoid market power findings that are patently false and that could undermine efforts to reach the right results in a host of other proceedings.

Sincerely,

/s/ David L. Lawson

David L. Lawson

cc: C. Libertelli
M. Brill
J. Goldstein
D. Gonzales
L. Zaina

[9] AT&T Triennial Review Reply Comments at 165-87, 240-68; AT&T ILEC Broadband Dominance Comments at 26-31.

[10] AT&T ILEC Broadband Dominance Comments at 23-25.

[11] *See* IDC, *U.S. Packet/Cell-Based Services Market Forecast and Analysis*, 2000-2005, at 34 (2001).